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**NOT TO BE PUBLISHED IN OFFICIAL REPORTS**



IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

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| NEVADA ATLANTIC CORPORATION,<br>Plaintiff and Respondent,<br>v.<br>WREC LIDO VENTURE, LLC,<br>Defendant and Appellant. | G039825<br>(Super. Ct. No. 06CC12605)<br>O P I N I O N |

Appeal from a judgment of the Superior Court of Orange County, Kirk H. Nakamura, Judge. Reversed.

Turner, Green, Afrasiabi & Arledge and Todd A. Green for Defendant and Appellant.

Michael F. Obrand for Plaintiff and Respondent.

The primary issue we review in this case is whether a commercial landlord may unreasonably withhold its consent to a proposed assignment where the lease requires the landlord's consent to the assignment and gives the landlord the right to withhold its consent "for any reason whatsoever or for no reason." The trial court determined a lease term giving the landlord sole discretion was essentially not subject to any standard, and accordingly Civil Code section 1995.260[1] required that a reasonable standard be implied to govern the landlord's decision. Applying this rule, the court concluded the landlord unreasonably withheld its consent to the lessee's proposed assignment. The landlord argues sole discretion is an acceptable standard, and in any event, the reasonableness question should have been decided by a jury. We conclude the parties' express agreement to a "sole discretion" standard is permitted under legal standards existing before and after enactment of section 1995.260, as long as the provision is freely negotiated and not illegal. The judgment is reversed.

I

The parties' predecessors in interest signed a lease in November 1985 for waterfront property used as George's Camelot Restaurant on Lido Marina in Newport Beach. Nevada Atlantic acquired the lease and the restaurant in 2001. WREC Lido Venture (WREC) is the landlord.

The lease prohibits assignments without the landlord's prior written consent, providing in relevant part: "Lessor shall have the absolute right to withhold its consent for any reason whatsoever or for no reason, it being understood that the giving or withholding of such consent shall be at Lessor's sole discretion."

In 2006, Nevada Atlantic agreed to sell the lease and restaurant to a third party and applied to WREC for consent to the assignment. WREC refused to consent and the sale fell through. Nevada Atlantic filed a lawsuit against WREC raising both

[1] All further statutory references are to the Civil Code, unless otherwise indicated.

equitable and legal claims. The first cause of action sought a judicial declaration that WREC give its consent, or in the alternative, show denial of consent is a reasonable business decision. The second cause of action alleged interference with prospective economic advantage.

Before trial, WREC moved to sever the legal and equitable claims. It requested the trial court rule on the equitable claims first. Over Nevada Atlantic's opposition, the court granted the motion. The parties agreed two issues would be tried by the court: (1) whether WREC had the right to refuse consent to the proposed assignment for any reason or no reason; and (2) assuming it did not, whether its refusal to consent was unreasonable.

The court considered evidence and testimony before it issued a statement of decision finding in favor of Nevada Atlantic. First, it determined WREC could not withhold its consent "for 'any reason'" as a matter of law. It stated the law clearly provides a lessor cannot use illegal or improper reasons to withhold consent. Second, the court determined the lease did not provide a standard for granting or refusing consent, explaining "the Legislature intended to allow landlords the right to withhold consent [to an assignment] even if the restraint was unreasonable, so long as an objective, understandable standard or condition was placed on the landlord's ability to withhold consent. Otherwise, the courts would imply a standard of reasonableness. [(§ 1995.260.)] A clause which provides the landlord the right to withhold consent for 'any reason' or 'no reason' and the lessor's 'sole discretion' certainly does not provide any objective standard to be applied." Applying the implied standard set forth in section 1955.260, the court concluded WREC acted unreasonably when it withheld consent to the proposed assignment. Nevada Atlantic voluntarily dismissed its remaining cause of action and the court entered judgment in its favor.

II

WREC raises two main issues on appeal. It first challenges the court's finding section 1995.260 requires the court to infer a reasonableness standard even though the lease expressly provides for a sole discretion standard. Alternatively, WREC argues that if sole discretion does not qualify as a standard, section 1995.260 was enacted after the lease was executed and should not be applied retroactively. Second, WREC challenges the court's finding it unreasonably withheld consent. As we will explain, we find the first argument has merit, rendering the second argument moot.

*A. Evolution of the law regarding transfers of commercial real property*

"Alienation in real property law has been defined as 'the transfer of the property and possession of lands, tenements, or other things, from one person to another.' (Black's Law Dict. (5th ed. 1979) p. 66.) Unless a lease specifically provides otherwise, a tenant's rights are generally considered freely alienable. [Citation.] Even where a lease contains a restriction, the restriction may be declared unlawful. [S]ection 711 provides: 'Conditions restraining alienation, when repugnant to the interest created, are void.' This section codifies the common law prohibition against unreasonable restraints. [Citations.]" (*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.* (1992) 2 Cal.4th 342, 354-355 (*Carma*).)

"In California, the modern struggle over restraints on alienation of leasehold interests began with *Richard v. Degen & Brody, Inc.* (1960) 181 Cal.App.2d 289 . . . . There, the appellate court adopted the majority view that: '"where a subletting or assignment of the leased premises without the consent of the lessor is prohibited, he may withhold his assent arbitrarily and without regard to the qualifications of the proposed assignee, unless . . . the lease provides that consent shall not be arbitrarily or unreasonably withheld. . . ."' [Citations.]" (*Carma*, *supra*, 2 Cal.4th at p. 355.)

This common law and majority view "remained the law in California until 1983 when a series of Court of Appeal decisions questioned the continued validity of the majority view.[2] These cases culminated in *Kendall v. Ernest Pestana, Inc.* [(1985)] 40 Cal.3d 488 . . . ( . . . *Kendall*), which adopted the minority view that a lease provision requiring consent to an assignment or sublease contains an implied covenant such consent shall not be unreasonably withheld. *Kendall* held 'such consent may be withheld only where the lessor has a commercially reasonable objection to the assignee or the proposed use.' [Citation.] *Kendall* noted denial of consent in these circumstances '"in order that the landlord may charge a higher rent than originally contracted for"' is not commercially reasonable. [Citation.]" (*Carma, supra,* 2 Cal.4th at p. 355.)

*Kendall* involved a "silent consent standard" clause that required the lessor's consent for transfer, but did not expressly state any standard for that consent. Due to the arguments raised in the briefs, it is worthwhile noting there are many different types of lease clauses that may govern the ability of a tenant to assign or sublease the leasehold interest. (See Myster, *Protecting Landlord Control of Transfers: The Status of "Sole Discretion" Clauses in California Commercial Leases* (1995) 35 Santa Clara L.Rev. 845, 852-855.) For example, there is: (1) the free alienability clause which expressly allows the tenant to sublease or assign at will; (2) the silent consent standard clause (used in *Kendall and Cohn*) which simply requires the tenant to receive the landlord's permission, but does not specify what standard governs the decision; (3) an

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[2] "In *Cohen v. Ratinoff* (1983) 147 Cal.App.3d 321 . . . a different division of the same district of the Court of Appeal that decided *Richard v. Degen & Brody, Inc.*[, *supra,* 181 Cal.App.2d 289] refused to follow that decision. It adopted the minority view that a lease provision requiring the lessor's consent to a sublease or assignment contains an implied covenant such consent shall not be unreasonably withheld. *Cohen* was followed by *Schweiso v. Williams* (1984) 150 Cal.App.3d 883 . . . . In both *Cohen* and *Schweiso,* the reviewing courts found the source of this reasonableness standard in the implied covenant of good faith and fair dealing. In *Hamilton v. Dixon* (1985) 168 Cal.App.3d 1004 . . . , the appellate court refused to apply this new rule to a lease executed prior to the effective dates of *Cohen* and *Schweiso*." (*Carma, supra*, 2 Cal.4th at p. 355, fn. 4.)

express standard for consent clause that could, for example, require the proposed company's profits must be three times larger than the rent in order to be approved; (4) the use restriction clause, which limits the tenant and assignee to certain uses of the property; (5) the profit shift clause that provides the landlord will receive any proceeds from increased rent; (6) the absolute prohibition clause that limits any assignment or sublease under any circumstances; and (7) the sole discretion standard clause under which the tenant must seek the landlord's approval and the landlord can unreasonably withhold consent. (*Id.* at pp. 852-855.)

In holding a standard of commercial reasonableness should be applied when the "silent consent standard provision" is specified, the Supreme Court in *Kendall, supra,* 40 Cal.3d at page 499, relied in part on the Restatement Second of Property, section 15.2, subdivision (2), which provides, "'A restraint on alienation without the consent of the landlord of the tenant's interest in the leased property is valid, *but the landlord's consent to an alienation by the tenant* cannot be withheld unreasonably, unless *a freely negotiated provision in the lease gives the landlord an absolute right to withhold consent*.'" (Second italics added.) The *Kendall* decision did not hold parties could not bargain and expressly provide for the sole discretion standard. The Supreme Court was careful to note, "This case does not present the question of the validity of a clause absolutely prohibiting assignment or granting absolute discretion over assignment to the lessor." In short, neither *Kendall*, nor the Court of Appeal cases preceding it, involved a lease containing an express grant to the landlord of absolute discretion as seen in the case before us now.

In 1989, the Legislature decided to codify the holding of *Kendall* to clarify the law relating to assignments and subleases of commercial property. (*Carma, supra,* 2 Cal.4th at p. 366.) The California Senate Judiciary Committee recognized the case left unresolved "whether a lease may absolutely prohibit assignment or grant absolute discretion to a landlord to prohibit an assignment." (Cal. Sen. Judiciary, Analysis of Sen.

Bill No. 536 (1989-1990 Reg. Sess.) as amended, Commercial and Industrial Leases: Assignment and Subleases, p. 3.)[3] The committee stated clarification would assist the following two policy judgments: (1) "Parties should be able to contract freely for any term, including an absolute ban to any transfer, so long as the result does not amount to an adhesion or unconscionable contract[]"; and (2) "Once an agreement is made, parties should be able to reply on and enforce the agreement unless a term or provision has proven to be unreasonable during the course of the contract." (*Ibid.*)

The California Law Review Commission also recommended clarification of the law governing transfers of commercial real property. It reasoned, "Certainty in the law and the ability to rely on a negotiated agreement are of primary importance in the commercial world. The parties need assurance that the rights and obligations under their tenancy agreement will be honored." (Recommendation Cal. Law Revision Com. of Sen. Bill No. 536 (Feb. 10, 1989) p. 5.)

The first proposed version of Senate Bill No. 536 specifically limited retroactivity of *Kendall* to leases executed after September 23, 1983, the date of the first appellate decision implying the reasonableness standard. It also included a provision devoted to clarifying that a lease may require the landlord's consent subject to express standards or conditions, such as: (1) "The landlord's consent may not be unreasonably withheld[]"; (2) "The landlord's consent may be withheld subject to express standards or conditions[]"; and (3) "The landlord has absolute discretion to give or withhold consent, including the right to unreasonably withhold consent." (*Id.* at p. 17.)

In reviewing Senate Bill No. 536, the Senate Judiciary Committee observed "Assumptions inherent in the Law Revision Commission's recommendations are that a tenant will have some if not absolutely equal bargaining power, and that any overly restrictive terms will be subject to attack as an adhesion contract or unconscionable

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[3] On our own motion, we take judicial notice of and consider the legislative history of Senate Bill No. 536 (§ 1995 et seq.).

clause. [¶] However, some tenants, such as 'mom-and-pop' operations, may not necessarily understand the import of a restrictive clause, may not have the means to hire professional counsel to advise them and negotiate a lease, or may be given a form lease on a 'take-it or leave-it' basis. If the offered lease provisions were especially restrictive as to the conditions for a transfer, the tenant's only recourse under the bill would be to challenge the provision as unreasonable . . . or as an unenforceable adhesion contract or unconscionable clause. This of course presents a paradox: If the 'mom-and-pop' tenant could not afford a lawyer to negotiate a lease, how could they afford a lawyer to contest a lease clause?" (Cal. Sen. Judiciary Analysis of Sen. Bill No. 536 (1989-1990 Reg. Sess.) as amended, Commercial and Industrial Leases: Assignment and Subleases, pp. 7-8.) The Committee recognized "notice and disclosure is a poor substitute for co-equal bargaining position," but suggested that it be required such restrictive clauses "be separately stated in bolder type and accompanied by an explanation of its effect." (*Ibid.*)

Nevada Atlantic correctly states the clause specifically approving sole discretion was omitted from the third vision of Senate Bill No. 536. We have reviewed the legislative history and found no stated reasons for the amendment. The summary and description of the bill was simply changed without any explanation. Nevada Atlantic argues it can be inferred the Legislature considered and expressly rejected the sole discretion as a permitted express standard. However, as aptly noted by one legal scholar, other reasonable inferences can be drawn from the amendment. "It is possible that 'sole discretion' clauses, which theoretically permit a landlord to unreasonably and arbitrarily withhold consent to transfer, were not politically popular. . . . The lack of any discussion suggests the Legislature purposely wrote the code sections in an ambiguous manner to allow 'sole discretion' clauses, while avoiding their explicit authorization." (Myster, *Protecting Landlord Control of Transfers: The Status of "Sole Discretion" Clauses in California Commercial Leases* (1995) 35 Santa Clara L.Rev. at p. 873, fns. omitted.)

Indeed, the final version of section 1995.250 is written broadly. It reads: "A restriction on transfer of a tenant's interest in a lease may require the landlord's consent for transfer subject to any express standard or condition for giving or withholding consent, including, but not limited to, either of the following: [¶] (a) The landlord's consent may not be unreasonably withheld. [¶] (b) The landlord's consent may be withheld subject to express standards or conditions." Section 1995.260 codifies the holding of *Kendall,* providing "[i]f a restriction on transfer of the tenant's interest in a lease requires the landlord's consent for transfer but provides no standard for giving or withholding consent, the restriction on transfer shall be construed to include an implied standard that the landlord's consent may not be unreasonably withheld. . . ."[4]

*B. Do sections 1995.250 and 1995.260 apply to this lease?*

The trial court concluded the implied standard of reasonableness described in section 1995.260 applies to the parties' commercial lease. Nevada Atlanta argues the court got it right because the lease provides no standard for giving or withholding consent for transfer. It argues sole discretion gives the landlord the right to withhold consent arbitrarily, and an arbitrary decision is not subject to any rule or standard.

On the other hand, WREC argues the sole discretion provision qualifies as a standard. It argues section 1995.250 permits the parties to expressly agree to any "standard or condition." It reasons the standard "when pigs fly" qualifies as an express standard and is permitted because landlords may absolutely prohibit transfers. WREC points out that landlords always possess the sole discretion to waive absolute transfer provisions so there is "no functional difference" between the "when pigs fly" standard prohibiting transfers from an express sole discretion standard for consent of transfers.

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[4] "Section 1995.260 applies only to leases entered into after September 23, 1983, the effective date of the Court of Appeal decision in *Cohen v. Ratinoff, supra,* 147 Cal.App.3d 321 . . . , which presaged *Kendall.* (§ 1995.270, subd. (b).)" (*Carma, supra,* 2 Cal.4th at pp. 366-367.)

Resolution of this dispute depends entirely on whether the subjective standard of a landlord's sole discretion qualifies as a standard or condition. It does not matter whether section 1995.260 applies retroactively because under the statutory scheme, the preexisting minority view stated in the Restatement Second of Contracts, and the preexisting majority view, parties may freely negotiate restrictive standards and conditions giving the landlord the absolute right to withhold consent.

As aptly noted by one legal commentator, "[T]he 'reasonable person standard in tort cases is essentially the standard of care the ordinarily prudent person would follow in similar circumstances. This 'standard' is ambiguous and subject to various interpretations, yet qualifies as a 'standard.'" (Myster, *Protecting Landlord Control of Transfers: The Status of "Sole Discretion" Clauses in California Commercial Leases* (1995) 35 Santa Clara L.Rev. at pp. 867-868, fn. omitted.) This author reasoned the sole discretion given to the landlord to refuse consent for unreasonable or arbitrary reasons is similar to the reasonable person standard as both prescribe "a general mode of conduct. The prerequisite event or fact dictated in a 'sole discretion' clause is that the landlord must subjectively approve the transferee prior to transfer." (*Ibid.*)

Moreover, because the words "standards" and "conditions" are ambiguously defined (see Black's Law Dict. (7th ed. 1999) pp. 1412-1413, 288 [defined as rules, measures, events, mode of conduct, and prerequisites]), we cannot create a presumption all standards must be objective, and not subjective. The Restatement of Contracts, and the statutory scheme requires only the restrictive standard be "express" to fairly put the lessee on notice. Contrary to Nevada's contention, we cannot rewrite the contract to insert a good faith objective clause when it appears the parties negotiated a lease with a contrary provision. The lease is not ambiguous. Not only did it include the clause stating, "the giving or withholding of . . . consent shall be at the lessor's sole discretion" it also clarified that under this standard the lessor had the "absolute right to withhold its consent for any reason whatsoever or for no reason." The agreement clearly

specifies a subjective sole discretion standard. It is already well settled that the covenant of good faith and fair dealing does not prohibit a party from doing what is expressly permitted by an agreement. (See 1 Witkin, Summary of Cal. Law (2005) Contracts, § 797, pp. 891-892; *Carma, supra,* 2 Cal.4th at p. 374.)

Finally, we recognize the trial court was concerned that giving the lessor sole discretion should not qualify as a standard because it would allow the landlord to base its decision on illegal or improper reasons. But as is the case in employment "at will" contract provisions, subjective discretion never permits illegal or discriminatory decisions. "[A]n employer may terminate its employees at will, for any or no reason. A fortiori, the employer may act peremptorily, arbitrarily, or inconsistently, without providing specific protections such as prior warning, fair procedures, objective evaluation, or preferential reassignment. Because the employment relationship is 'fundamentally contractual' [citation], limitations on these employer prerogatives are a matter of the parties' specific agreement, express or implied in fact. The mere existence of an employment relationship affords no expectation, protectable by law, that employment will continue, or will end only on certain conditions, unless the parties have actually adopted such terms." (*Guz v. Bechtel National Inc.* (2000) 24 Cal.4th 317, 350; Lab. Code, § 2922.) However, California courts recognize a narrow exception to this rule: "[A]n employer's traditional broad authority to discharge an at-will employee 'may be limited by statute . . . or by considerations of public policy.'" (*Tameny v. Atlantic Richfield Co.* (1980) 27 Cal.3d 167, 172.) An employer's obligation to refrain from violating public policy does not depend upon any express or implied contractual promises, "but rather [it] reflects a duty imposed by law upon all employers." (*Id.* at p. 176.)

Similarly, commercial landlords cannot act illegally or against public policy. For example, section 51, subdivision (b), of the Unruh Civil Rights Act prohibits discrimination by business establishments based on "sex, race, color, religion, ancestry,

national origin, [or] disability." (See also § 782 [prohibiting discriminatory restrictions in deeds].) A landlord exercising sole discretion in considering an assignment cannot make the decision based on illegal grounds.

As for improper decisions, a lease provision may be challenged under other principles of contract law. Overly restrictive terms may be attacked as being unconscionable or contained in an adhesion contract. As noted at the beginning of this opinion, a lease provision may be deemed an unreasonable restraint on alienation. (§ 711 ["Conditions restraining alienation, when repugnant to the interest created, are void"].) In light of the above authority, we conclude there are protective statutes in place to address the case when a lessor has exercised its sole discretion in an illegal or improper manner. We hold a freely negotiated sole discretion clause is a permissible standard under the majority view, minority view, and section 1995.250.

III

The judgment is reversed. Appellant shall recover its costs on appeal.

O'LEARY, ACTING P. J.

WE CONCUR:

ARONSON, J.

FYBEL, J.